No. 7483

# In the United States Circuit Court of Appeals for the Ninth Circuit

EDNA SMART SHERMAN, PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

*ON PETITION FOR REVIEW OF DECISION OF THE UNITED STATES BOARD OF TAX APPEALS*

## BRIEF FOR THE RESPONDENT


FRANK J. WIDEMAN,
*Assistant Attorney General.*
SEWALL KEY,
JOHN MacC. HUDSON,
FREDERICK W. DEWART,
*Special Assistants to the Attorney General.*

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## CITATIONS





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## BRIEF FOR THE RESPONDENT

### OPINION BELOW

The only previous opinion in this case is that of the United States Board of Tax Appeals (R. 37–40), which is reported in 29 B. T. A. 616.

### JURISDICTION

The appeal involves income taxes for the year 1929 and is taken from an order of the Board of Tax Appeals entered on December 28, 1933 (R. 41). The case is brought to this Court by petition for review filed March 15, 1934 (R. 41–46), pursuant to Sections 1001–1003 of the Revenue Act of 1926, c. 27, 44 Stat. 9, as amended by Section 1101 of the Revenue Act of 1932, c. 209, 47 Stat. 169.

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### QUESTION PRESENTED

By the agreement of May 12, 1926, did petitioner waive or transfer to her husband her interest in the community income, including his salary?

### STATUTES INVOLVED

The applicable provisions of the statutes involved will be found in the Appendix, *infra,* pp. 13–14.

### STATEMENT

The Board made findings of fact, which were in substance, as follows (R. 37–38):

The petitioner is, and for a long time prior to the taxable year, was the wife of Frederick Royal Sherman. Husband and wife are residents of San Francisco, California, but since some time in 1926 have lived separately. On May 12, 1926, they entered into an agreement in which the husband agreed to transfer all his rights, title, and interest in certain real and personal property to the petitioner. That agreement reads as follows (R. 29):

> WITNESSETH: Whereas the parties hereto are husband and wife, and have three minor children, namely, Mary Frances Sherman, Edna Sherman, and Clay Sherman; and
>
> WHEREAS the party of the first part desires to insure the future support and maintenance of his said wife and children;
>
> NOW, THEREFORE, said party of the first part, in consideration of the sum of One ($1.00) Dollar in hand paid, the receipt of which is hereby acknowledged, and of the love and affection which he has for his said

family, and for the purpose of insuring their future support and maintenance, undertakes and agrees as follows:

Said first party agrees to and he does hereby transfer and convey * * *.

Certain property is thereafter enumerated.

It also provides (R. 31):

> Said first party further agrees that he will pay to said second party the sum of One Thousand ($1000.00) Dollars per month for the support and maintenance of said second party and said minor children, beginning on the 1st day of June 1926.

And also (R. 32):

> In event said second party should remarry, said monthly payment of $1,000.00 shall be reduced to an amount which in the opinion of said second party would be sufficient and adequate for the support, maintenance, education and care of the children of the parties hereto.

The instrument evidencing such agreement specifies and describes all the assets to be transferred. It makes no mention of community property or community interests. In it there is no mention of income or of the right to receive income. This agreement was subsequently somewhat amended but the changes are not material to the issues here. In the taxable year the husband received a salary of $22,500 and in his Federal income-tax return included the whole amount thereof in his gross income. Upon audit the respondent de-

termined that one half the husband's salary, or $11,250, should be taxed to the wife and determined a refund to the husband in the amount of $1,007.13, which was paid to him. In her return for 1929 the petitioner reported no part of her husband's salary as income. Upon audit of such return the respondent added the amount of $11,250 representing one half the husband's salary for the taxable year to petitioner's gross income, made other adjustments not now material here, and determined the deficiency under review.

The Board sustained the Commissioner, holding that the sum of $11,250 should be included in petitioner's return as income and determined a deficiency income tax, due on this and certain other adjustments, in the amount of $7,243.90.

## SUMMARY OF ARGUMENT

*United States* v. *Malcolm,* 282 U. S. 792, determined that the wife should pay Federal income tax on one-half of the community income of husband and wife domiciled in California. Petitioner and her husband were a marital community at all times during 1929. The agreement between petitioner and her husband of May 12, 1926, transferred certain rights and property to her, and he agreed to pay her a certain sum monthly, but the agreement makes no mention of community property or community interests and no mention of income or the right to receive income. This agreement is unambiguous, full, and complete, contains all the terms

of the agreement, and cannot be varied or added to by testimony of the parties. The agreement does not waive or transfer to the husband, petitioner's interest in his salary or other income, and petitioner must report and pay Federal income tax on her one-half of his salary and the other community income. No cases have been found which hold otherwise, and the decision of the Board in this case is in strict accord with the decision of this Court in *Helvering* v. *Hickman,* 70 F. (2d) 985.

## ARGUMENT

**Under the agreement of May 12, 1926, petitioner did not waive or transfer to her husband her interest in the community income and one-half of the husband's earnings are her income under the Federal tax statutes**

In *United States* v. *Malcolm,* 282 U. S. 792, the Supreme Court of the United States held that the wife should separately report and pay income tax on one-half the community income of the husband and wife domiciled in California.

The rights of the husband and wife in property are determined by the Civil Code of California, 1931, in Sections 161 (a), 162, 163, 164, and 177, *infra,* pp. 13–14.

In 1929 petitioner's husband received a salary of $22,500. This was income of the community unless the marital community ended before that time or unless petitioner had waived or transferred to her husband, as his separate property, her interest in that income.

The community existed and survived throughout that taxable year. In California the community ends only with the death of one of the parties or by legal decree of divorce. Neither of these elements had occurred in this case.

Under the California decisions not even an interlocutory decree of divorce terminates the community. *Estate of Seiler,* 164 Cal. 181; *Olson* v. *Superior Court,* 175 Cal. 250; *Brown* v. *Brown,* 170 Cal. 1, cited with approval by this Court in *Patents Process, Inc.* v. *Durst,* 69 F. (2d) 1014.

Petitioner contends that by the agreement of May 12, 1926, she waived or transferred to her husband her interest in the community income. We maintain there is no basis whatever for this claim.

The agreement of May 12, 1926, states (R. 29):

> WHEREAS the party of the first part desires *to insure the future support and maintenance of his said wife and children;*
>
> NOW THEREFORE, said party of the first part, in consideration of the sum of One ($1.00) Dollar in hand paid, the receipt of which is hereby acknowledged, and of the *love and affection which he has for his said family, and for the purpose of insuring their future support and maintenance* * * *.
>
> * * * * *
>
> Said first party further agrees that he will pay to said second party the sum of One Thousand ($1,000.00) Dollars per month *for the support and maintenance of said second party and said minor children,* * * *. (Italics supplied.)

In said supplementary agreement of February 11, 1927, it is stated (R. 33):

> WHEREAS the parties hereto did on the 12th day of May 1926 make and enter into an agreement of that date *with reference to the proper future support and maintenance by said first party of said second party and the children of said parties;* * * *. (Italics supplied.)

These instruments bear evidence of having been carefully drawn and by a lawyer.

Section 1638 of the Civil Code of California, 1931, provides:

> The language of the contract is to govern its interpretation, if the language is clear and explicit, and does not involve an absurdity.

And Section 1639 of that Code provides:

> When a contract is reduced to writing, the intention of the parties is to be ascertained from the writing alone, if possible, subject, however, to the other provisions of this title.

Section 1856 of the Code of Civil Procedure, 1931, provides that when the terms of an agreement have been reduced to writing, it is to be considered as containing all of the terms.

It will be observed that petitioner gives nothing whatever of any kind. As we have noted, the sole consideration for the transfer from the husband is his love and affection for his wife and children.

Nowhere in the agreement does the petitioner transfer, convey, or relinquish any property or right of property or community interest.

There is nothing to indicate how much, if any, other property or rights the parties possessed, and it does not specify that it is a full property settlement.

The language of the agreement "is clear and explicit, and does not involve an absurdity", and, therefore, "the intention of the parties is to be ascertained from the writing alone". (Civil Code of California, 1931, Secs. 1638, 1639, *supra.*)

Petitioner was asked the leading question if she intended to make a complete division of her property rights with her husband, terminating her community interest in any existing property and in his earnings and salary thereafter. She said, "Yes; I did." The Board member allowed the question over the objection of the Commissioner, by saying, "I think you may ask the question. I don't think it can have any effect. We will interpret the contract according to its terms. We have no choice in the matter" (R. 51).

While we believe that the answer should have been stricken, the accompanying statement of the Board member was strictly correct. In *Lemm* v. *Stillwater Land & Cattle Co.,* 217 Cal. 474, 482, the court said (p. 482):

> Whether as a question of fact the parties had the intention to contract with reference

> only to those matters or things which comprised the subject of the action in which the agreement was filed was a question primarily for the trial court to decide from the evidence of the surrounding circumstances and the negotiations leading up to the embodiment of the agreement into its written form. The court, if it erred at all in this respect, committed error in permitting any of the parties to the negotiations to testify respecting his belief or conclusion as to what was included in the settlement. "*Swain* v. *Grangers Union* (69 Cal. 186 [10 Pac. 404].)
> * * *.

The finding by the Board of the ultimate fact that petitioner did not waive or transfer to her husband her interest or share in his earnings, has substantial evidence to sustain it, and, therefore, is binding on this Court. *Tricou* v. *Helvering,* 68 F. (2d) 280 (C. C. A. 9), certiorari denied, 292 U. S. 655; *Winnett* v. *Helvering,* 68 F. (2d) 614 (C. C. A. 9).

Section 1647 of the Civil Code of California, 1931, provides that a contract may be explained by reference to the circumstances under which it was made, and the matter to which it relates. The rule of evidence embodied in this section may be invoked only in cases where, upon the face of the contract itself, there is a doubt, and the evidence is used to expel that doubt. *United Iron Wks.* v. *Outer H. etc. Co.,* 168 Cal. 81.

There is no doubt or possible question on the face of the contract or in the wording of the contract as to what it says and means, so that testimony may not be admitted to change or add to the contract. We submit that it is complete, clear, explicit, and final.

The decision of the Board is strictly in accordance with the decision of this Court in *Hervering* v. *Hickman*, 70 F. (2d) 985. In that case there was an agreement between husband and wife that the earnings of each was to remain his separate property, and it was held that those earnings never became community property. The Court said (pp. 987–988):

> By the law of California, as construed by her courts, the earnings of the wife never became community property if the husband and wife have agreed that they shall be and remain her separate property, hence, under the decision in *Poe* v. *Seaborn,* such earnings *should not be taxed as income to the husband.*
>
> The government relies upon our decisions in *Blair* v. *Roth,* 22 F. (2d) 932, decided December 1927, and *Belcher* v. *Lucas,* 39 F. (2d) 74, decided March 31, 1930. Both of these cases were decided before the decision of the Supreme Court in *Poe* v. *Seaborn, supra,* and of course, if inconsistent therewith, were overruled thereby. In *Blair* v. *Roth, supra,* the contract between the spouses was held by this court to be in-

> sufficient to constitute a portion of the income of the community the separate property of the wife. The agreement in the case of *Belcher* v. *Lucas, supra,* was held by us to be substantially the same as that in *Blair* v. *Roth.* In neither case was there a clear-cut agreement that the wife should have her own earnings as her separate property; in both cases there was a partnership agreement by which the earnings of both were joined in one fund to pay expenses of both and remainder only was to be owned equally. It was held in both cases that the earnings of the husband and of the wife became community property before the agreement became effective to make the balance after payment of expenses, separate property.

The cases cited by petitioner are all based on different facts, as the husband and wife in those cases had made an express agreement with regard to their earnings, so that none of those cases are applicable to the case in hand. We have found no cases which would sustain petitioner's claim.

There being no reference in the agreement to any waiver by this petitioner of her share of community income, the rights and obligations of the parties with respect to the community income, including the duty to report and pay a tax thereon, are the same as if the agreement of May 12, 1926, had never been entered into, and the income of the community belongs one-half to each spouse and must be so reported for Federal income-tax purposes.

## CONCLUSION

We submit the decision of the Board of Tax Appeals is correct and should be affirmed.

Respectfully submitted,

FRANK J. WIDEMAN,
*Assistant Attorney General.*

SEWALL KEY,
JOHN MACC. HUDSON,
FREDERICK W. DEWART,
*Special Assistants to the Attorney General.*

JANUARY 1935.

## APPENDIX

Civil Code of California, 1931:

*Section 161a. Interests in community property.*—The respective interests of the husband and wife in community property during continuance of the marriage relation are present, existing and equal interests under the management and control of the husband as is provided in section 172 and 172a of the Civil Code. This section shall be construed as defining the respective interests and rights of husband and wife in community property.

*Section 162. Separate property of the wife.*—All property of the wife, owned by her before marriage, and that acquired afterwards by gift, bequest, devise, or descent, with the rents, issues, and profits thereof, is her separate property. The wife may, without the consent of her husband, convey her separate property.

*Section 163. Separate property of the husband.*—All property owned by the husband before marriage, and that acquired afterwards by gift, bequest, devise, or descent, with the rents, issues, and profits thereof, is his separate property.

*Section 164. Property acquired after marriage.*—All other property acquired after marriage by either husband or wife, or both, including real property situated in this state, and personal property wherever situated, heretofore or hereafter acquired while domiciled elsewhere, which would not have been the separate property of either if acquired

while domiciled in this state is community property; * * *.

*Section 177. Rights of husband and wife governed by what.*—The property rights of husband and wife are governed by this chapter, unless there is a marriage settlement containing stipulations contrary thereto.

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